

LOAN COMMITTEE

April 21, 1986
LC/M/86/11

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Minutes of Loan Committee Meeting to consider
Tunisia Agricultural Sector Adjustment Loan (ASAL)
Held on March 24, 1986 in Room E-1208

A. Present

Committee:

Mr. Stern, SVPOP
Mr. Husain, OPSVP
Mr. Wood, FPBVP
Mr. Scott, LEGVP
Mrs. Krueger, VPERS
Mr. Wapenhans, EMNVP

Others:

Mr. Schuh, AGRDR
Mr. Clements, SVPOP
Mr. El Serafy, CPDDR
Mr. Rogers, VPERS
Mr. Huang, CPDBA
Mr. Bhatia, IMF
Mr. Dairy, IMF

Region:

Mr. Stoutjesdijk, EM2DR
Mr. Goffin, EMPDR
Mr. O'Sullivan, EMPA2
Mr. Erim, EM2C
Mr. Seth, EMPA2
Mr. Bachmann, EM2C
Mr. Lister, EMPA2
Ms. Hubert, EM2C

B. Issues

1. The meeting was called to consider the following issues emerging from the Initiating Memorandum of March 14, 1986, submitted to the Loan Committee for approval to appraise a proposed Agricultural Sector Adjustment Loan (ASAL):

- (i) the magnitude of macroeconomic adjustments needed, and the absence of a Fund program and a SAL;
- (ii) the need for an agreed time-bound program to align agricultural producer prices to international levels and remove subsidies on inputs;

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COMMITTEE

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Senior Vice President, Finance
Vice President & General Counsel
Vice President, Operations Policy
Regional Vice President concerned*
Vice President, Energy & Industry (for lending
in these sectors and SALs)
Vice President, Economics and Research (for non-
project lending)

OTHERS

Standard (see OMS 9.25 page 7)

*Copy to all other Regional Vice Presidents

- (iii) the investment program and the role of Government in the agricultural sector; and
- (iv) the possibility of limited competitive bidding for fertilizer procurement.

C. Discussion

2. Economic Adjustment Program. The Region distributed prior to the meeting a summary table outlining the macroeconomic scenario for the period 1981-91 and 1995, assuming that the adjustment program detailed in the Initiating Memorandum is carried out. It noted that, due to the declining price of oil, difficulties in phosphate exports, declining workers' remittances and lowered expectations for tourism growth, the projections are less optimistic than when the Synopsis Paper was prepared in mid-1985. GDP growth is now expected to be limited to 3.6% p.a. A Committee member expressed the belief that the seriousness of Tunisia's economic situation and the distortions in the economy required more vigorous action from the Government for fundamental reform - e.g. substantial exchange rate adjustment and rapid actions to liberalize the economy. It was felt that these actions could best be pursued through a SAL and IMF program. The Chairman noted that the Bank had neither the mandate nor the expertise to propose specific exchange rate adjustments and enquired about the IMF's position in this regard. The IMF representative indicated that in the Fund's judgment a 15-20% downward adjustment of the exchange rate would appear appropriate, but noted that the Government had so far not sought IMF assistance; at the most, compensatory financing might be sought. An Article IV mission is tentatively planned for July 1986. Neither of these vehicles, however, would give the IMF leverage on the exchange rate issue. The Committee agreed that an agreement with the Government on a more flexible exchange rate system was needed, and that close cooperation would be required between the Bank and the Fund in this area. As regards a SAL, the Region noted the Government's lack of agreement to this approach, which it associates with crisis situations, and the Region's belief that the same purpose could be served by tying the Bank's sector lending to an agreed macroeconomic framework. The Region also indicated that, given Tunisia's current political situation and the extent to which controls have been built into the system, a reasonable period to achieve full liberalization should be accepted by the Bank. The Committee agreed to the Region's approach, but insisted that the macroeconomic program must be a strong one, with significant actions in the short-term, backed up by the Government's commitment to the ultimate objective of a liberalized system. The Chairman indicated that this ASAL should be a first step toward a SAL.

3. Agricultural Prices and Incentives. The Region confirmed that the Government's ultimate objectives in this area were an across-the-board alignment of producer prices to border prices and elimination of input subsidies. In order not to worsen the sector's terms of trade relative to other sectors and thus abruptly disrupt the pricing and incentive system, these actions would have to be phased over a time frame appropriate for each element as indicated in the Initiating Memorandum. To encourage the efficient

local production of livestock products and cereals, the above actions should be accompanied by consumer price liberalization in those commodities (beef and fresh milk) where Government subsidy intervention is not judged to be essential, and improvement in the system of administered consumer prices where it is more sensitive (cereals), as well as by 15% tariffs on imports of these commodities. These tariffs would also compensate for the significant current under-protection of agriculture (5-10%) relative to industry (70%), the latter to be gradually reduced under the macro program. The Committee accepted this approach, but emphasized that the Government should clearly articulate its commitment to the ultimate objectives of producer pricing at international levels and input subsidy removal, while improving the sector's adverse terms of trade relative to industry. It also questioned the need for a pricing and incentives study, given the ultimate objective of freeing the system of controls and the constant changes which would be required over the next few years to meet this goal. The Region explained that the proposed work on prices and incentives was not intended to be used to continue the system of setting price and subsidy levels, but rather was designed to establish in Tunisia the capacity for monitoring the transition path and the evolution of the sector's terms of trade.

4. The Investment Program and the Role of Government. A Committee member questioned why it was proposed that 20% of total investments should be allocated to agriculture, noting that it was more important to define the criteria for including investments in the program. He felt that the Bank should also ensure the acceptability of the Government's total investment program. The Region confirmed that criteria were being developed for total agricultural investments as well as for a core program and that application of these criteria would be monitored under the ASAL. It noted that the 20% was an indicative figure, chosen because of the Government's interest in slightly increasing the share of agriculture during the VIIth Plan period, as opposed to the VIth Plan period, in particular to ensure that the sector's import substitution potential is fully exploited. As regards the overall investment program, the Region indicated that the Bank would have an important input via a Public Expenditures Review to be started in mid-1986. The Committee emphasized that the Government's commitment should be obtained to the objective of reducing its role in the provision of agricultural services, with agreement on short-term steps to withdraw from commercially-viable activities and to improve cost recovery in others to be monitored under the ASAL.

5. Procurement. The Committee indicated that limited competitive bidding for fertilizer imports would not be acceptable.

D. Conclusion

6. Subject to the above comments, the Committee approved the recommendation to appraise the Agricultural Sector Adjustment Loan.

Cleared by: Members of the Loan Committee